

December 29, 2004

Barbara A. Schermerhorn
ClerkNOT FOR PUBLICATION**UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE TENTH CIRCUIT**

IN RE TONY A. HAZBOUN and
RANDA E. HAZBOUN, also known as
Randa Dabbas,

Debtors.

BAP No. UT-04-033

DAVID TAYLOR and PAULA K.
TAYLOR,

Plaintiffs – Appellants,

v.

TONY A. HAZBOUN and RANDA E.
HAZBOUN,

Defendants – Appellees.

Bankr. No. 00T-29175
Adv. No. 00PT-2288
Chapter 7

ORDER AND JUDGMENT*

Appeal from the United States Bankruptcy Court
for the District of Utah

Before McFEELEY, Chief Judge, BOHANON, and BROOKS¹, Bankruptcy
Judges.

PER CURIAM.

David S. and Paula K. Taylor (the “Taylors”) timely appeal a final
Judgment of the United States Bankruptcy Court for the District of Utah²
awarding the Chapter 7 debtors attorney’s fees and costs pursuant to 11 U.S.C.

* This order and judgment is not binding precedent, except under the
doctrines of law of the case, res judicata, and collateral estoppel. 10th Cir. BAP
L.R. 8018-6(a).

¹ Honorable Sidney B. Brooks, United States Bankruptcy Judge, United
States Bankruptcy Court for the District of Colorado, sitting by designation.

² 28 U.S.C. § 158(a)(1); Fed. R. Bankr. P. 8002(a).

§ 523(d).³ The parties have consented to this Court's jurisdiction because they have not elected to have this appeal heard by the United States District Court for the District of Utah.⁴ For the reasons stated, the bankruptcy court's Judgment is REVERSED.

I. Background

The Taylors financed the debtors' purchase of a home. The debtors paid the Taylors \$20,000 from borrowed funds as a down payment, and executed a Promissory Note in favor of the Taylors for the remaining \$156,000 purchase price. This Promissory Note required the debtors to make monthly payments to the Taylors, and a balloon payment within two years. The debtors' obligation under the Promissory Note was secured by a Trust Deed against the home.

The debtors paid the Taylors monthly under the Promissory Note. As the time neared to make the balloon payment, the Taylors agreed to the debtors' proposal to refinance the home purchase through a conventional lender. Through this refinance, the Taylors were paid \$115,425.90, a new Promissory Note with a principal balance of \$42,000 was executed, and the Taylors were granted a new Trust Deed against the home, second in priority to the conventional lender's Trust Deed. The Taylors allegedly agreed to a second priority lien against the home based on the debtors' promise to pay the new Promissory Note promptly out of future expected bonuses, or through proceeds of yet another refinanced loan.

On August 17, 2000, after making two monthly payments to the Taylors under the new Promissory Note, the debtors filed a Chapter 7 petition. The conventional lender obtained relief from the automatic stay to pursue its rights against the home. The debtors' case was administered as a no-asset Chapter 7

³ Unless otherwise stated, all future statutory references in the text are to title 11 of the United States Code.

⁴ 28 U.S.C. § 158(b)-(c); Fed. R. Bankr. P. 8001(e).

case.

The Taylors examined the debtor-husband pursuant to Federal Rule of Bankruptcy Procedure 2004. Shortly thereafter, they commenced an adversary proceeding against the debtors, seeking a determination that the debtors' debt to them under the new Promissory Note was nondischargeable pursuant to § 523(a)(2)(A). The Taylors conducted discovery, and later moved to amend their Complaint to add a § 523(a)(2)(B) cause of action (Motion to Amend). During this period, the debtors moved for summary judgment on the § 523(a)(2)(A) action (Summary Judgment Motion). The Taylors opposed the debtors' Motion and filed an Affidavit in support of their objection, but they did not specifically contest the Statement of Facts set forth in the Motion.

The bankruptcy court denied the Taylors' Motion to Amend (Amendment Order), and granted the debtors' Summary Judgment Motion, thus dismissing the Taylors' Complaint. In entering Summary Judgment, the bankruptcy court first noted that the Taylors were deemed to have admitted the facts asserted by the debtors in their Motion because they had not specifically contested them. It also struck several paragraphs of the Taylors' Affidavit because it contained inadmissible hearsay. Viewing the facts on the record in a light favorable to the Taylors, the bankruptcy court held that the Promissory Note debt was dischargeable. Most significant to entry of the Summary Judgment was the bankruptcy court's conclusion that the Taylors had presented "little or no evidence" that the debtors' representations were made with fraudulent intent, or that the Taylors relied on those representations.⁵

The Taylors filed a motion to reconsider both the Amendment Order and the

⁵ Summary Judgment, Memorandum Decision and Order at 7, Appellants' Appendix at 352; *see id.* at 8, Appellants' Appendix at 353.

Summary Judgment, which tolled the time to appeal those rulings.⁶ While that motion was pending, the debtors filed a motion seeking an award of attorney's fees and costs pursuant to § 523(d) (First Fee Motion). They requested \$15,648 in fees and \$610 in costs related to their defense of the Taylors' § 523(a)(2)(A) action. The First Fee Motion was supported by a Memorandum of Law, as well as by an Affidavit of debtors' counsel, attached to which are the itemized time records of the professionals who worked on the § 523(a)(2)(A) action.

While the First Fee Motion was pending, the bankruptcy court denied the Taylors' reconsideration motion, and the Taylors appealed the Amendment Order and Summary Judgment to the United States District Court for the District of Utah. The Taylors then opposed the First Fee Motion, claiming that it was premature in light of their appeal of the Summary Judgment and, alternatively, arguing that fees and costs were not allowable under § 523(d) (Fee Objection). The bankruptcy court sustained the Fee Objection on the basis that the Motion was premature, stating: "[D]ue to the appeal of this Court's order granting Summary Judgment pending before the U.S. District Court, this Court retains jurisdiction over the motion and the hearing on this motion is continued without date until the entry of a final non-appealable order respecting the appeal."⁷

The District Court ultimately entered an Order affirming the bankruptcy court's Amendment Order and Summary Judgment. Its decision to affirm was based in part on the fact that the Taylors had failed to file an adequate record for review.

Shortly after the District Court entered its Order, the debtors filed in the District Court a request for decision on the First Fee Motion that had been filed in

⁶ Fed. R. Bankr. P. 8002(a)-(b).

⁷ Order Re: Motion For Award of Attorney Fees and Costs at 2, Appellants' Appendix at 774.

the bankruptcy court, and an additional request for fees and costs incurred in their prosecution of the appeal and in their request for fees (Appellate Fee Motion). Thus, through the Appellate Fee Motion, the debtors sought three categories of fees and costs: (1) fees totaling \$15,648, and costs of \$616, for prosecution of the § 523(a)(2)(A) action in the bankruptcy court; (2) fees totaling \$9,020, and costs of \$401.18, for prosecution of the appeal in the District Court; and (3) fees in an unspecified amount related to their request for § 523(d) fees and costs.

While the Appellate Fee Motion was pending before the District Court, the debtors filed a Motion in the bankruptcy court, requesting the exact same relief sought in the Appellate Fee Motion (Renewed Fee Motion). The Taylors did not file an objection to the Renewed Fee Motion, but rather relied on the arguments made in their earlier Fee Objection to the First Fee Motion.

Before the bankruptcy court addressed the Renewed Fee Motion, the District Court entered an Order denying the Appellate Fee Motion (Appellate Fee Order).⁸ The District Court refused to rule on the First Fee Motion and the fee request therein, holding that it lacked jurisdiction to do so because that Motion was properly before the bankruptcy court. But, it denied the debtors' request for fees and costs related to the appeal, summarily stating that the Taylors' "contentions on appeal *were* substantially justified" and, therefore, fees for the appeal were not allowable under § 523(d).⁹

After the Appellate Fee Order was entered, the bankruptcy court held a

⁸ Debtors' counsel represented to the bankruptcy court that the Appellate Fee Motion was inadvertently filed in the District Court because he put the wrong caption on the pleading. He failed to withdraw the Appellate Fee Motion and, therefore, the Appellate Fee Order was entered by District Court. Counsel stated: "I expect to be able to correct that with [the District Court] by reconsideration or depending on the ruling of this Court today." Transcript at 12, Appellants' Appendix at 455. We have no record that such acts were taken.

⁹ Appellate Fee Order at 2 (emphasis in original), Appellants' Appendix at 438.

hearing on the Renewed Fee Motion. The Taylors appeared and objected to the fees and costs sought by the debtors based on the legal arguments in their Fee Objection, and the District Court's disallowance of appeal-related fees and costs. They presented no evidence at the hearing in support of their objection.

The bankruptcy court subsequently entered a "Memorandum Decision Determining Award of Attorneys Fees" and a separate Judgment, granting the Renewed Fee Motion in part and denying it in part. The bankruptcy court held that it was required under § 523(d) to award the debtors the fees and costs related to their prosecution of the § 523(a)(2)(A) action because the Taylors had not shown that their position was "substantially justified."¹⁰ Of the over \$15,000 in fees requested by the debtors for the § 523(a)(2)(A) action, the bankruptcy court allowed them \$8,000, and it awarded the debtor's entire \$616 request for costs. The bankruptcy court stated that its Judgment did not include the appeal-related fees and costs that were disallowed by the District Court in the Appellate Fee Order.

The Taylors appealed the bankruptcy court's Judgment to this Court. The issue on appeal is whether the bankruptcy court erred in awarding the debtors fees and costs pursuant to § 523(d).

II. Discussion

Section 523(d) states:

If a creditor requests a determination of dischargeability of a consumer debt under subsection (a)(2) of this section, and such debt is discharged, the court shall grant judgment in favor of the debtor for the costs of, and a reasonable attorney's fee for, the proceeding if the court finds that the position of the creditor was not substantially justified, except that the court shall not award such costs and fees if special circumstances would make the award unjust.¹¹

Under § 523(d), if a debtor shows that a dischargeability action was filed pursuant

¹⁰ 11 U.S.C. § 523(d).

¹¹ *Id.*

to § 523(a)(2), the debt sought to be discharged was a “consumer debt”¹² and that the debt was discharged, the burden shifts to the plaintiff-creditor to show that its position in the § 523(a)(2) action was “substantially justified” or, if not, that “special circumstances” would make a fee award unjust.¹³ When a debtor proves the first three elements of § 523(d) and the creditor fails to prove substantial justification or special circumstances, the bankruptcy court must award the debtor reasonable fees and costs.¹⁴

There is no question in this case that the debtors proved the first three elements of § 523(d): the Taylors’ action was brought pursuant to § 523(a)(2)(A), all parties agree that the debt in question is a “consumer debt,” and the debt was discharged by the bankruptcy court’s Summary Judgment. Accordingly, the issue is whether the bankruptcy court erred in concluding that the Taylors failed to prove that the § 523(a)(2)(A) action was not substantially justified, or that special circumstances existed to make the § 523(d) award unfair. Because we conclude that the Taylors did show that their position was substantially justified, we need not address the existence of special circumstances.

A “bankruptcy court’s determination of whether the position of a creditor is “‘substantially justified’ or whether ‘special circumstances’ exist is . . . reviewed for abuse of discretion.”¹⁵ Under this standard, “a trial court’s decision will not be disturbed unless the appellate court has a definite and firm conviction that the

¹² *Id.* § 101(8) (defining “consumer debt” as a “debt incurred by an individual primarily for a personal, family, or household purpose[.]”); *see Citizens Natl. Bank v. Burns (In re Burns)*, 894 F.2d 361 (10th Cir. 1990) (debt incurred with profit motive not a “consumer debt” for purposes of §§ 101(8) and 523(d)).

¹³ *Household Bank, N.A. v. Sales (In re Sales)*, 228 B.R. 748, 752 (10th Cir. BAP 1999).

¹⁴ 11 U.S.C. § 523(d) (“the court shall grant judgment in favor of the debtor”); *Bank of New York v. Le (In re Le)*, 222 B.R. 366, 371 (Bankr. W.D. Okla. 1998).

¹⁵ *Sales*, 228 B.R. at 752 (citing cases).

lower court made a clear error of judgment or exceeded the bounds of permissible choice in the circumstances.”¹⁶ For the reasons discussed below, the bankruptcy court abused its discretion in concluding that the Taylors’ § 523(a)(2)(A) action was not substantially justified.

The substantially justified test in § 523(d) is the same as that set forth in § 2412(d)(1)(A)¹⁷ of the Equal Access to Justice Act.¹⁸ In *Pierce v. Underwood*,¹⁹ the United States Supreme Court concluded that the connotation “most naturally conveyed by [substantial justification] is not ‘justified to a high degree,’ but rather ‘justified in substance or in the main’ – that is, justified to a degree that could satisfy a reasonable person. That is no different from the ‘reasonable basis both in law and fact’ formulation”²⁰ The Court further stated: “To be ‘substantially justified’ means, of course, more than merely undeserving of sanctions for frivolousness; that is assuredly not the standard for . . . litigation of which a reasonable person would approve.”²¹ “But, a position can be justified

¹⁶ *Moothart v. Bell*, 21 F.3d 1499, 1504 (10th Cir. 1994) (citation and quotation omitted).

¹⁷ This section states:

Except as otherwise specifically provided by statute, a court shall award to a prevailing party other than the United States fees and other expenses, in addition to any costs awarded pursuant to subsection (a), incurred by that party in any civil action (other than cases sounding in tort), including proceedings for judicial review of agency action, brought by or against the United States in any court having jurisdiction of that action, unless the court finds that the position of the United States was substantially justified or that special circumstances make an award unjust.

28 U.S.C. § 2412(d)(1)(A).

¹⁸ *Id.* § 2412(d) *et seq.*; see *Burns*, 894 F.2d at 363 n.2 (quoting S.Rep. No. 65, 98th Cong., 1st Sess. 9-10 (1983)).

¹⁹ 487 U.S. 552 (1988).

²⁰ *Id.* at 565.

²¹ *Id.* at 566.

even though it is not correct, and we believe it can be substantially (*i.e.*, for the most part) justified if a reasonable person could think it correct, that is, if it has a reasonable basis in law or fact.”²²

The Court of Appeals for the Tenth Circuit has stated that to meet the “reasonable in law and fact” test set forth in *Pierce*, parties attempting to prove substantial justification must show: “a reasonable basis for the facts asserted; a reasonable basis in law for the legal theory proposed; and support for the legal theory by the facts alleged.”²³

In applying the reasonableness test, courts are directed to look to the record of the entire case.²⁴ In *Pierce*, the Court discussed factors that appellate courts should consider when evaluating whether a trial court has abused its discretion in making a substantial justification determination. It stated that “‘objective indicia,’ such as the terms of a settlement agreement, the stage in the proceedings at which the merits were decided, and the views of other courts on the merits, . . . can be relevant, . . . [but] they [do not] provide a conclusive answer” in all cases.²⁵

Since *Pierce*, the Tenth Circuit has further defined criteria that may be considered in reviewing findings of substantial justification. In *Hadden v. Bowen*,²⁶ decided several weeks after *Pierce*, the Tenth Circuit held that a lack of substantial evidence is not *per se* lack of substantial justification. It stated: “a lack of substantial evidence on the merits does not necessarily mean that the

²² *Id.* n.2.

²³ *Harris v. Railroad Retirement Bd.*, 990 F.2d 519, 520-21 (10th Cir. 1993) (citing *Gaston v. Bowen*, 854 F.2d 379, 380 (10th Cir. 1988)); accord *Gutierrez v. Sullivan*, 953 F.2d 579, 585 (10th Cir. 1992).

²⁴ See 28 U.S.C. § 2412(d)(1)(B), *quoted in Gaston*, 854 F.2d at 380.

²⁵ 487 U.S. at 568.

²⁶ 851 F.2d 1266 (10th Cir. 1988).

[plaintiff's] position was not substantially justified."²⁷ Furthermore, in *Estate of Michael Patrick Smith v. O'Halloran*,²⁸ the Tenth Circuit noted that the fact that a district court upholds an administrative decision does not establish substantial justification.

The bankruptcy court concluded that the § 523(a)(2)(A) action against the debtors was not substantially justified. It stated that “even giving the [Taylors] the benefit of the doubt as to their theory of recovery, . . . the Taylors presented little or no evidence regarding the alleged intent to deceive that is required under § 523(a)(2)(A).”²⁹ The bankruptcy court further noted that “The Taylors have not presented sufficient new evidence [at the hearing on the Renewed Fee Application] to show that they were ‘justified to a degree that could satisfy a reasonable person.’”³⁰

The Taylors maintain that the bankruptcy court erred because there existed a reasonable basis at law for their § 523(a)(2)(A) action given the alleged facts. Their argument is largely a collateral attack of the Summary Judgment -- the Taylors maintain it was entered in error because a genuine issue of fact existed as to whether the debtors incurred the new Promissory Note debt based on fraud, false pretenses or false representations. We may not entertain this collateral attack as the Summary Judgment is a binding final order.

Yet, in reviewing the bankruptcy court's conclusion that the Taylors' position in § 523(a)(2)(A) was not substantially justified, we may consider the entire record, including the merits of the Taylors' litigating position in that

²⁷ *Id.* at 1269.

²⁸ 930 F.2d 1496 (10th Cir. 1991).

²⁹ Memorandum Decision and Order at 5, Appellants' Appendix at 477 (quoting Memorandum Decision and Order in support of Summary Judgment at 7).

³⁰ *Id.* (quoting *Pierce*, 487 U.S. at 565).

action.³¹ In so doing, we conclude that the bankruptcy court erred in finding that the Taylors' position was not substantially justified.

After the Taylors commenced the § 523(a)(2)(A) action, they made discovery requests and responded to papers filed in the bankruptcy court. Included among the filed papers were memoranda and an Affidavit in opposition to the debtors' Summary Judgment Motion.³²

While Summary Judgment was entered in favor of the debtors, thus discharging their unpaid debt to the Taylors under the new Promissory Note, the basis for the Summary Judgment was largely due to the Taylors' failure to expressly contest the facts alleged by the debtors in their Summary Judgment Motion and the deficiency of their Affidavit. This caused the bankruptcy court to deem the debtors' version of the facts to be admitted by the Taylors.

The District Court affirmed the bankruptcy court's Summary Judgment in large part because the Taylors did not provide it an adequate record for review. It also determined that the Taylors' appeal of the Summary Judgment was substantially justified.

Based on the totality of all of the facts, divined from a review of the entire record in this case, we conclude that the Taylors' position in the § 523(a)(2)(A) action was substantially justified and, therefore, the bankruptcy court erred in awarding fees and costs to the debtors pursuant to § 523(d). While the Taylors failed to produce substantial evidence in support of their position, this does not conclusively establish a lack of substantial justification.³³ An objective review of the whole record reveals that the Taylors' position was litigated in good faith, but

³¹ *Pierce*, 487 U.S. at 565.

³² The papers we are taking into account are those that were filed prior to the hearing on the Summary Judgment Motion, not supplemental replies and Affidavits filed by the Taylors after that hearing.

³³ *Hadden*, 851 F.2d at 1266.

not very effectively. While ineffective litigation may be grounds for a § 523(d) award in some situations, in this case we conclude that it is not.

III. Conclusion

The bankruptcy court's Judgment is REVERSED.